

# Market Update

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## Weak Link in the Chain

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Wall Street is so upset with the horrendous write-downs at banks and financial companies that they sold everything. During January (2008) the Dow slid 4.6%, while the S&P 500 dropped 6.1% (its worst January in 18 years) and the NASDAQ plunged 9.9%, its worst January in history. The "banking" system is a mess which will likely continue to plague this sector with additional write downs all year and into 2009. Their solution is to attract new capital to rebuild their financial statements and thereby allow for future lending (using more conservative standards).

Over the past few years when the Fed raised interest rates from 1% to 5.25%, such actions have historically caused a weak link in the financial chain to break. The weak link in the chain this time is the home loan problem. Low interest rates and lax underwriting of home loans created irrational exuberance in real estate. It will likely be several years before the real estate market and related financial areas recover.

Washington and the Fed are responding with aggressive economic stimulus and interest rate reductions (dropping interest rates 1.25% in late January to 3%). These actions are designed to thaw the frozen credit markets and prevent the economy from slipping into a recession. Other foreign intervention will also help. It may be a gutsy call, but our research sources do not foresee a recession; the economy will be very soft with slow growth. This environment lends itself to a decline in oil prices and continued inflation.

Fiscal and monetary stimulus will soon influence stocks, maybe within a few months, maybe as early as late March (next Fed meeting) to late May (Congress economic stimulus checks). We are presently 4 months into the bear market correction (started in October), and it will turn 8 months old in May. In the interim, we will likely retest the January market lows as we build a base for a new market rally. Stocks, particularly domestic, represent the cheapest asset in client portfolios.

	<u>January</u>	<u>3 Months (since 10/31)</u>
Small Value	-4.7%	-12.1%
Large Value	-4.9%	-10.0%
Mid Value	-5.0%	-10.7%
S&P 500	-6.1%	-10.7%
Large Growth	-9.0%	-12.6%
Mid Growth	-9.3%	-13.6%
Foreign	-10.0%	-15.4%
Small Growth	-10.0%	-16.4%

Bonds provided a safe haven for investors, as Treasuries set the pace for every other US bond category. Fears of recession drove investors to higher-quality bonds. Intermediate government bonds rose over 2% in value during January. Bonds represent the most expensive asset class in client portfolios.

We are looking for opportunities to invest accumulated cash into under-target stock allocations. The stock value retreat has left them under-owned in client portfolios. Our challenge is to sort out the bear market rallies that fail after a few days (on low volume) from the start of the next bull market run. We continue to own a diversified mix of stock and bond mutual funds.

### Humorous Thoughts for Wounded Spirits (Money Matters)

- There are a lot of things that money can't buy; what it did ten years ago.
- The quickest way to double your money is to fold it over and put it back in your pocket.
- The average American family's ambition is to make as much money as they're spending. The best advice: Act your wage!
- Inflation hasn't ruined everything. A dime can still be used as a screwdriver.

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